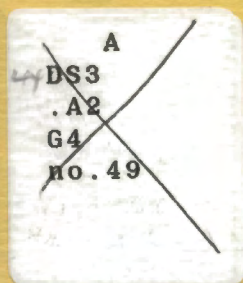


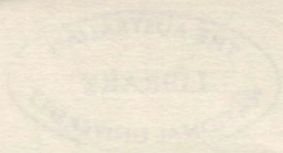
The Forty-ninth George Ernest Morrison Lecture in Ethnology 1988

CHINA: ONE COUNTRY, TWO SYSTEMS

ROSS GARNAUT



The Australian National University
Canberra



CHINA: ONE COUNTRY, TWO SYSTEMS

CHINA: ONE COUNTRY, TWO SYSTEMS

ROSS GARNAUT

The Forty-ninth
George Ernest Morrison Lecture
in Ethnology 1988

S/A
A
DS3
A2
G4
S910806

The Australian National University
Canberra



The Australian National University

This book is copyright. Apart from any fair dealings for the purposes of private study, research, criticism or review, as permitted under the Copyright act, no part may be reproduced by any process without written permission.

ISBN 0 7315 0803 3
ISSN 0 726-2523

Printed by Socpac Printery
For Research School of Pacific Studies
The Australian National University
Canberra

CHINA: ONE COUNTRY, TWO SYSTEMS

George Ernest Morrison went to China without any knowledge of the Chinese language and knowing little about Chinese history and institutions. He exhibited extraordinary self-confidence and courage, some might add recklessness, throughout his life and travels in China. We can be glad he did. Morrison's writings became the medium through which many in the West saw more of the humanity of China in the late nineteenth century. His powers to observe and record sympathetically many details of the human condition in, for him and us, an unusual setting, are apparent to readers today.

Some aspects of his view of Chinese humanity mark him as a man comfortable with the prevailing British attitudes of the Age of Imperialism. Morrison became a hero of the imperialist powers when the Peking legations were under siege during the Boxer Rebellion: in the words of an admiring survivor, 'as dirty, happy and healthy a hero as one could find anywhere'.* And yet he was irreverent about the faith and institutions of imperialism in China. Who can ever forget his matter-of-fact indictment of the missionary in China: the missionary knew that only those who had heard and rejected the faith were damned; he knew from experience that few in China who heard the Gospel would accept the faith; and he thus knowingly persisted in sending countless millions to the fires of Hell.

I thought it appropriate to draw my topic from a set of problems left over from the Morrison era of imperialism, and of great contemporary importance to China and the rest of the world, including Australia. My subject is the interwoven destinies of three parts of China that are now administered separately: mainland China, Hong Kong, and Taiwan. It should really be four, but the fate of Macau is being settled without much excitement, incidental to the larger forces working on the history of Hong Kong. Constitutional evolution in Macau has its own

* See reference to contemporary quotation in Peter Fleming, *The Siege at Peking* (Oxford University Press, Hong Kong, 1983), p.160.

character and importance, but I will not make a long story longer by including it in this lecture.

One and a half centuries ago, Hong Kong and Taiwan were integral parts of China's Qing Empire, then by far the largest economic and political entity on Earth. That was before aggressively successful industrial capitalism in the West and Japan had played their parts in the undermining of the ancient order in China.

Hong Kong entered British administration in three parts. The island was a prize of the First Opium War in 1842. It had been identified, with brilliant prescience, by the British and other buccaneer traders who were working the South China Coast as an excellent base for the economic penetration of Qing China. The mainland peninsula of Kowloon, facing the island, was forced from China twenty years later. And then in 1898, during times of turmoil in Qing China's relations with the outside world, the Chinese government leased to Britain for ninety-nine years the New Territories, inland from Kowloon.

The New Territories afterthought of Britain's colonization of Hong Kong was to play a pivotal role in the ultimate resolution of the constitutional fate of Hong Kong. By the last quarter of the twentieth century, Hong Kong, now a great industrial as well as commercial metropolis, had grown so far into the New Territories that its separate existence was not contemplated seriously by the British authorities or by Hong Kong's business leadership. The end of the New Territories lease in 1997 was accepted as a crucial date for establishing a new constitutional basis for the administration of Hong Kong island and Kowloon as well.

Taiwan, which under the Qing dynasty was administered as part of Fujian Province, was ceded to Japan in 1895, following Japanese military victories. Japan's rule ended with its defeat in the Second World War. The United Nations accepted Chinese sovereignty over Taiwan, and after the surrender this was recognised by the defeated powers. Only four years later, Taiwan became the place of retreat of the Kuomintang after the Communist victory on the mainland. Ever since, the Kuomintang administration in Taiwan has shared with the Communists in Beijing a commitment to eventual reunification.

This separation of China into three parts is the setting for a major act in Chinese history: the attempt by the People's Republic of China to end these separations of the age of imperialism in a manner that does not compromise modernization and China's opening to the outside world. It is happening now and in this way because of the confluence of three inter-related historical trends: the development of confidence within the People's Republic in open policies to the rest of the world; the success of and the economic pressures unleashed by internationally oriented economic policies in Hong Kong, Taiwan and now mainland China; and the realignment of Sino-American relations in the context of superpower competition, symbolized by the United States' recognition of the People's Republic as the legal government of one China one decade ago. How this act is played is of decisive importance to six million people in Hong Kong and nineteen million in Taiwan, but not only to them. It is centrally important to the success of the Chinese Communist Party's ambitious programme of modernization. It is of no small importance to stability and peace on a world scale.

The Economic Integration of Hong Kong and the Mainland

Late last year I travelled by car from Hong Kong, across the border through Shenzhen to Guangzhou, the old Canton. I was one of about twenty million who that year crossed what is now one of the world's busiest border points.

In Shenzhen, huddled against the border, you now see a mini-Hong Kong – a forest of high rise buildings; a million people living at a material standard much higher than elsewhere in the People's Republic of China.

Shenzhen is bursting at the seams. Its industrial areas are filled with activity, mostly representing joint ventures with Hong Kong enterprises, exporting much of their output to or through Hong Kong. Shenzhen's exports last year were worth one billion US dollars, having roughly doubled in each of the preceding two years. At first Hong Kong enterprises had sent over the border only the most simple and labour-intensive processes. Now, with Hong Kong's labour force and industrial

infrastructure tautly stretched, Shenzhen is finding a place for itself a few rungs up the ladder in the international division of labour.

All this activity took me by surprise. I had last visited Shenzhen in late 1985. Then I had been impressed mainly by the huge investment in industrial and social infrastructure. As an economist, I had been sceptical about whether this investment would be utilized quickly enough to pay its way.

The Special Economic Zone of Shenzhen had been established a few years before, at the site of a sleepy village, as a place to experiment with capitalist forms of economic organization, free trade and low taxation. One of its roles was to facilitate the expansion of economic links with Hong Kong. By late 1987, the judgement of the Chinese visionaries of 1983 had been proven more sound than that of the foreign sceptic of 1985.

Travelling beyond the Shenzhen Special Economic Zone, with its separate customs arrangements, you encounter a fence, like a second border. In Baoan County, hard against the Shenzhen fence, there is another island of intense industrial activity. Enterprises, usually linked to Hong Kong by ownership and management ties, use labour that is more abundant and cheaper than in Shenzhen to mass-produce and assemble components for more sophisticated manufacture in Shenzhen and Hong Kong.

Moving away from the clusters on the second border, the process of economic specialization continues, based on simpler processes and yet more abundant and cheaper labour. Through the villages of Baoan County, some manufacture is put out to cottage industry, and ultimately linked to an international division of labour through Hong Kong.

You soon realize you are entering the economic influence of another large city, a teaming, vibrant city, almost as populous as Hong Kong, and intimately connected to the neighbouring metropolis by the overlapping of radio and television reception, by kinship ties and the constant movement of people, and by a dense web of business connections. Guangzhou is the major industrial centre as well as the political capital of Guangdong Province, which the powerful momentum of export-oriented industrial growth over recent years has made China's premier export province.

The drive from Hong Kong to Guangzhou reveals five different styles of economic organization, five different levels of material living, and nearly as many sets of rules about the movement of people and capital. In many ways, that initial step from Hong Kong to Shenzhen is no larger than the other steps along the way. Many economic systems are operating alongside each other within modern China.

I was told a year ago that Hong Kong linked enterprises were employing one million workers in manufacturing activities in Guangdong Province – either in joint ventures or in co-production financed from Hong Kong. This is as many as are employed in manufacturing in Hong Kong itself.

One of the many fears expressed in Hong Kong about the future under Chinese sovereignty is that China may seek to supplant the role of Hong Kong in China's trade and development through the strengthening of cities on the mainland – variously, Shanghai or new cities such as Shenzhen. But Hong Kong need not fear. The British buccaneers of the 1840s had chosen well their base for trade with China, at the best natural deepwater port on the South China coast. These natural advantages have been enhanced by the building of a huge, efficient physical and business infrastructure uniquely linked to the international economy.

The influx of capital and skills after 1949 widened Hong Kong's links of kinship and language up the coast to Zhejiang and Shanghai. The economic value of these assets had increased greatly over the past decade, as China's modernization under the new open policies has gained momentum.

The Sino-British Agreement of late 1984 has diminished inhibitions in the People's Republic about making full use of Hong Kong's advantages. Elsewhere I have described the effects on the Hong Kong economy of this easier interaction with the Chinese mainland as being comparable to the effects on New York of the opening of the railroads in the nineteenth century, or, more appropriately in Australia's bicentennial year, to the effects on Sydney of the crossing of the Blue Mountains.*

* Address as Australian Ambassador to China, to Australian Chamber of Commerce, Hong Kong, 26 February 1988.

The past couple of years have been the most prosperous and buoyant in the brilliant economic history of Hong Kong. Real output of goods and services increased by 14 per cent. The parts of the Hong Kong economy which expanded most rapidly were those geared to providing trading, financial communications and other services to China.

During the year, the real value of total merchandise trade grew by one-third. Re-exports expanded almost by half, and domestic exports almost by one-quarter. Trade with China was the most dynamic component of trade. Domestic exports to China increased by over half, and re-exports by a similar proportion. The volume of total imports from China increased by over two fifths. China supplied one-third of total Hong Kong imports and absorbed one-quarter of total Hong Kong exports. Re-exports to and from China expanded more rapidly than any other component of trade, by 60 per cent, accounting for more than three quarters of the total entrepot trade.

This powerful reassertion of Hong Kong's entrepot role for the mainland has continued in 1988. Over the first four months of this year, re-exports to and from the mainland expanded by a further 44 per cent. In early 1988 the value of the entrepot trade exceeded domestic exports for the first time since Hong Kong became a major producer of manufactured goods in its own right some decades ago.

By late last year, Hong Kong, like Shenzhen, was bursting with growth as it strove to meet the rising demands of economic relations with the mainland. Kwai Chung became the busiest container port in the world. Congestion at the Kai Tak Airport caused long delays, with Taiwan visitors, many of them headed into China, becoming the largest group. Queues of lorries lengthened at the border crossings. Unemployment fell to the lowest levels ever recorded. Real wages rose strongly. Construction wage rates rose by 30 per cent in nominal terms and 22 per cent in real terms between late 1986 and late 1987. Construction and manufacturing enterprises reported desperate shortages of labour, and employers called for the loosening of restrictions on immigration.

The Hong Kong authorities resisted pressures to increase the rate of immigration. The intake from the mainland was held at the

established level, which had been contributing about 0.5 per cent per annum to the Hong Kong population.

Inflationary pressure deriving from labour scarcity and rising real wages was alleviated considerably by the movement across the border into Guangdong Province of many labour-intensive manufacturing processes, a phenomenon that came to be known as outward processing. A large part of the strong growth in domestic merchandise exports to China represented textile, electronic, watch, toy and other components for further manufacture and assembly. A large part of the growth in the return trade to Hong Kong represented later stages in these processes. This movement in response to labour shortages and inflationary pressures in Hong Kong was, of course, the other side of the coin to the export-oriented industrial boom in Shenzhen, Baoan and Guangzhou.

Hong Kong's role in the open door policies of China extends well beyond Guangdong Province. There is an important sense in which the open policies in China have represented first of all an opening to integration with Hong Kong. Two thirds of the joint ventures with external capital under the open policies have involved Hong Kong partners. In recent years, the greater part of the huge export growth of China has been to or through Hong Kong.

Mainland enterprises have also become major participants in the Hong Kong economy. Over recent years, the conglomerate China Resources, has been investing in Hong Kong at the rate of US\$100 million per annum, and at a similar rate back into the mainland from a Hong Kong base. Investments have been made in a wide range of construction and manufacturing activities. The China International Trust and Investment Corporation has in a short time become a major player in Hong Kong civil aviation, banking and real estate. Many mainland businesses were busy purchasing Hong Kong equities in the aftermath of last October's Stock Market crash and its mismanagement by the Hong Kong Stock Exchange.

Even before the recent explosive growth of economic relations with the People's Republic, several decades of strong economic growth had introduced powerful pressures for structural change towards stronger specialization in higher value activities, requiring higher skills and more capital. The strengthening educational standing and skills of

the Hong Kong population supported this industrial transformation. The combination of the increasingly complementary resource base of the mainland, with its huge abundance of labour, and the Chinese Communist Party's commitment to reform and opening to the outside world, has created an historic opportunity for Hong Kong to employ more of its skills and capital in the high-value activities that it is best able to perform – the provision of highly sophisticated business, transport and communications services linking China to the outside world. Recent political developments have further facilitated the process of re-specialization, contributing to unprecedented prosperity on both sides of the border.

The economic conditions are now present for a similarly productive re-specialization in production and trade across the Taiwan Straits. We are now seeing the beginning of this economic integration.

The realization of the potential benefits from increased economic interaction between Taiwan and the mainland is closely linked to the development of political relations across the Straits. Political and economic forces are interacting in complex ways, which will be strongly influenced by perceptions of the success of constitutional evolution in Hong Kong.

Political Integration: One Country, Two Systems

The Chinese Civil War has never ended, according to the contestants on the two sides of the Straits. For three decades there was not much surface evidence of change in relations between them. Each spoke of 'liberating' the territory held by the other. The People's Liberation Army periodically fired big guns from the Fujian coast, and Kuomintang forces responded in kind.

There has never been any chance of early military victory by either side since the United States committed itself to the defence of the Kuomintang in Taiwan at the beginning of the 1950s. And from the late 1950s, other larger processes were at work that would eventually deny the People's Liberation Army the prospect of a straightforward and low-cost military victory even against the Kuomintang forces standing alone. Despite an impressive early start with reconstruction and nation

building, Mao Zedong's China lost the chance for rapid modernization and economic growth in the craggy heights of the Great Leap Forward and the swamps of the Cultural Revolution. Meanwhile the Kuomintang was putting together the elements of a new export-oriented development strategy which, in a quarter-century from the early 1960s, was to propel productivity and incomes in Taiwan close to the frontiers of the international economy.

The Civil War history and the Taiwan administration's stronger economic and military position made Taiwan a more important reunification issue than Hong Kong to the Beijing leadership.

Beijing's approach to reunification changed soon after the decisive political victory of the reformist coalition put together by Deng Xiaoping in December 1978. China's new policies of reform and opening to the outside world needed stability and peace. China needed co-operation with the West; and that would be helped greatly by the continuation of the role of Hong Kong as an efficient link to the international economy. These imperatives interacted with recognition of two realities of the environment for reunification: that there would be no early opportunity for the mainland to force its way into an unwilling Taiwan except at enormous cost; and that in the end Britain would settle for the best deal it could get for Hong Kong beyond 1997.

These imperatives and realities were woven together in a bold new concept: the idea that one country, China, could operate with two, political and economic systems, a socialist system on the mainland and a capitalist system in Taiwan and Hong Kong.

Restrictions on links with Taiwan were replaced by the encouragement of the 'three contacts' – contacts through exchanges of people, mail and communications, and trade. Older rhetoric about the liberation of Taiwan was replaced by calls for peaceful reunification through negotiation. The shelling of the offshore islands ceased. The new rhetoric carefully avoided, however, any final renunciation of the use of military force should all else fail.

The Taiwan authorities reacted cautiously to this new approach. China needed, they said, not 'one country, two systems', but 'one country, one good system'. They rejected the call for 'three contacts'

with an assertion of 'three nos': 'no contact, no negotiation, no compromise'.

While these formal propositions have been unchanged since the early 1980s, there has been a substantial shift in the environment within which reunification has been contemplated on each side of the Straits. The increasing momentum of economic reform has been reducing systemic differences. Continued economic success has allowed Taiwan to establish itself as an entity with substantial weight in the international economy. Rapidly rising living standards in Taiwan have generated pressure for and underpinned a significant process of political liberalization. This has entailed some public questioning of established Kuomintang positions on contacts with the mainland and also on reunification. Economic change on both sides of the Straits has increased greatly the value of and therefore the pressures towards economic integration.

Significant movements of goods and people across the Straits began, including investment through Hong Kong companies, all banned by the Taiwan authorities. And the pressures for democratization of authoritarian rule on Taiwan, which accompanied economic growth and rising living standards, began to encompass opposition to the economic and social costs of the Kuomintang's rejection of contacts.

These pressures have been reflected in major changes in the Kuomintang's approach to contacts over the past ten months. The announcement last October by Chiang Kai-shek's son and successor, Chiang Ching-kuo, that visits to relatives on the mainland would be permissible for all but restricted categories of people on Taiwan, was followed by an explosion of interest in the mainland. Over the next nine months 200,000 people made the journey. Last year, travellers ran into Taiwan pilgrims at airports and hotels all over coastal China, at factories deep inland in Chongqing, and on tourist boats through the Yangtze Gorges. The Taiwanese found themselves observers of a world so changed – more ordered and prosperous than the China they had once known and than the China of the Kuomintang media, and much less prosperous than the China they now knew in Taiwan.

Since the death of Chiang Ching-kuo early this year there has been no loss of momentum. The new leadership steered the Kuomintang

Congress to significant liberalization of trade with the mainland in May. Two-way trade, already valued at US\$1.5 billion when still banned last year, is currently expanding rapidly under the combined influence of increasingly favourable underlying conditions, increased personal contact, and liberalization in Taiwan. Taiwan investment is also becoming rapidly more visible on the mainland.

The mainland, for its part, has encouraged each of these developments with welcoming but low-key responses. Taiwan goods enjoy free trade with the mainland, in preference to foreign goods. But in the inimitable fashion of Chinese bureaucracy, free trade is (I was told by senior officers of Chinese enterprises participating in the trade) modified by a tariff, lower than the foreign tariff, that brings prices up to the levels of mainland goods where the Taiwan products are 'too competitive'. Taiwan travellers and investors have received preferred treatment over foreign competitors.

Pressures for and initial steps towards 'democratization' on Taiwan have increased momentum for more contact with the mainland, but also have led to questioning of the Kuomintang commitment to reunification. This has been accompanied by an important shift in the manner in which the Kuomintang itself talks of reunification. Increasingly the Taiwan leadership speaks as if it believes that 'one country, one good system' will emerge not from a military push to reclaim the mainland, but from Taiwan's demonstration of the superior achievements of its style of capitalism. Taiwan is paying close attention to the practical implementation of 'one country, two systems' in Hong Kong.

The Hong Kong Experience

Hong Kong is nervous and speculative. Any occasion for optimism or gloom is exaggerated in the retelling around Hong Kong and eventually finds its way into stock-market and real-estate values, and if it lasts long enough into investment and economic growth. The gloom has usually been strongest at any sign that Beijing was contemplating a change in the political status of Hong Kong, or itself undergoing political change that might affect Hong Kong. Hence the breaks in the powerful trend of growth, with short periods of absolute economic decline early and late in

the Cultural Revolution. Hence also the periods of panic on financial markets prior to the announcement of the Sino-British agreement in December 1984. (One such period of panic led to the pegging of the Hong Kong dollar to the US dollar as a stabilization device.)

The Sino-British Joint Declaration established the principles under which Hong Kong was to be guaranteed the retention of a capitalist economic system for half a century after 1997.

- Whilst Hong Kong was to be restored to the sovereignty of China from 1 July 1997, the Hong Kong Special Administrative Region thereafter would enjoy a high degree of autonomy, except in foreign affairs and defence.
- The Hong Kong Special Administrative Region would be vested with executive, legislative and independent judicial power, including that of final adjudication. Laws currently in force in Hong Kong would remain basically unchanged.
- The government would be composed of local inhabitants, and the Chief Executive appointed by the Chinese government on the basis of local elections or consultations.
- The legislature would be constituted through elections. It would enact laws and report them to China's National People's Congress. The laws would be valid if they were in accordance with the Basic Law that China had drawn up for Hong Kong's post-1997 administration.
- The current social and economic systems, education system, rights and freedoms and lifestyle in Hong Kong would remain unchanged.
- Hong Kong would remain fiscally separate from the mainland, with free trade and no foreign exchange control.
- These principles were to be embodied in the Basic Law, which would become the Constitution of the Hong Kong Special Administrative Region.

A draft of the Basic Law was released for public comment in April this year. The Draft Basic Law is an elaborate first attempt to give detailed expression to the principles of the Joint Declaration. It defines a

complex relationship and balance of power between the Chief Executive and the Legislature. As noted, there is a long list of rights which are to be preserved, a Hong Kong Bill of Rights. Several alternative formulas for direct and indirect elections to the legislature are put forward for discussion, although none approximating direct elections with universal suffrage. An attempt is made to protect from popular politics a number of features of established Hong Kong capitalism: for example, a requirement for balanced budgets.

Hong Kong is a city of commerce, unaccustomed to debating fine points of constitutional law and political democracy. Many commentators have drawn attention to the low level of public interest in discussion of the Basic Law. Nevertheless, Hong Kong's economic development has spawned a substantial middle class, discussion within which has uncovered all of the usual dilemmas of constitution-making, and several unique to the Hong Kong environment. There is anxiety about whether the sources of real political power – in this case, the central authorities – will play by the rules.

Beyond this fundamental question about a new constitution, the discussion has identified two paradoxes of the Hong Kong condition. One is that to preserve the system of rights and freedoms within which Hong Kong operates, it is necessary to change fundamentally the legal basis of those rights. A literal reading of the law within which Hong Kong has prospered gives large, indeed, draconian powers to the colonial authorities. Hong Kong democrats have, through the current debate, come to identify the essence of individual liberties in Hong Kong as deriving from official restraint, which itself derives from British parliamentary democracy rather than any laws applicable in Hong Kong itself. Hence there has arisen the view that it is not enough for the current law to be maintained, but that a list of defined rights, and even direct elections to the legislature, are necessary to preserve the *status quo* in relations between the state and the individual.

The second paradox is that to preserve Hong Kong's system as it currently exists requires the denial of tendencies to change and development that are inherent in the system itself. The natural evolution of Hong Kong as incomes and education levels rise, and with them a more numerous and self-confident middle class, probably entails greater

popular participation in and influence on economic and social policy-making. ^o

Here there is tension within the politically aware Hong Kong community itself – between members of the business and administrative elite who fear that democratization would challenge the basis of *laissez faire*; and democrats who see promise in changes to the established fiscal and wider economic order. No final answers to this tension can emerge except through observation of the Hong Kong constitution in practice: certainly no answers that satisfy the whole of the political *cognoscente*.

The people of Hong Kong have lived with high insecurity and uncertainty for half a century. There is a long tradition of successful Hong Kong business people buying insurance through investment abroad. Emigration of professionals, with internationally recognized tertiary qualifications, has always been part of the Hong Kong scene.

The contemporary insecurity and uncertainty cannot compare with those times in the Cultural Revolution when hillsides of apartments were red with flags of the People's Republic, when traffic stopped before the tides of Red Guards, when threat and rumour of threat told of the imminent cutting of essential services from the mainland. At these times, Hong Kong stopped for a while, but survived, and went on to prosper as never before.

But the people of Hong Kong have changed in the intervening years. Today, some members of a more numerous middle class, powering a more sophisticated economy, are rich and well educated enough to value abstract freedoms and democratic hopes above increments in material living standards. Many Chinese residents of Hong Kong are now well informed about opportunities abroad that were unknown and inaccessible to their parents' generation. Many more Hong Kong Chinese, with their greater wealth and education, now qualify within the less discriminatory immigration regimes of Canada and Australia.

The outcome is unprecedented interest in emigration and, from what information can be pieced together, unprecedented rates of emigration. The rate at which 'Certificates of No Criminal Conviction' have been issued to people applying for immigration visas to recipient

countries has increased sharply, from around 20,000 per annum earlier in the 1980s, to 36,000 in 1986 and 52,000 in 1987. The number of Australian immigration visas issued rose sharply from 4,500 in 1985/86 to 8,000 in 1987/88, making Hong Kong Australia's largest source of business migrants and third-largest source of all migrants. Canada is said to be issuing immigration visas at three times this rate.

Emigrants are overwhelmingly economically successful professional and business people. These numbers are large in comparison with the stock of people from which they are drawn: in 1986, only 300,000 people in Hong Kong had any form of tertiary qualification and a total of only 12,000 students were enrolled in Hong Kong's two universities. An acceleration of emigration from the current high rates, should the emigration turn out to be permanent and not simply the purchase of insurance, seriously could undermine Hong Kong's capacity to perform its economic role.

Some Implications for the Future

Economic growth in Hong Kong and Taiwan, and reform and the open policies on the mainland, have brought powerful new forces to play on the environment for reunification.

Economic integration between Hong Kong and the mainland has advanced a long way since the Sino-British Declaration, to the great advantage of the prosperity of each. The resulting unprecedented prosperity in Hong Kong provides a valuable cement in holding the community together through the constitutional transition.

There are powerful economic incentives for close integration of the Taiwan and mainland economies. These economic forces have played their part in the sculpting of attitudes in Taiwan to contact with the mainland. It is now likely that we will see the building of new towns, extensions of old towns and new dimensions of dynamism around the coast from Hong Kong to Shanghai – spurred by Taiwan capital, business leadership and trade.

The full yield from economic integration can be won only within a durable stable political framework. 'One country, two systems' is a bold Chinese proposal for the resolution of what had appeared to be

irreconcilable differences over the future of Hong Kong and Taiwan. The Chinese and British governments have worked in good faith, and the Chinese intend to maintain the capitalist economy in Hong Kong for half a century beyond 1997.

But even Hong Kong Chinese who share this confidence have concerns about whether existing institutions – subtle, complex, undefined and probably indefinable – will continue to work after the constitutional change. Hence the emigration, which could reduce the chances of success whatever the objective realities of constitutional succession.

If things appear to be going well – if it looks likely that, without the Raj, the successful combination of firm, relatively honest, undemocratic enforcement of the rules of a *laissez faire* market economy and substantial social and economic freedom can be maintained – not all of the immigration visas will be used, and many former Hong Kong people will return to work holding a foreign nationality. In the end, the fate of one of the great constitutional innovations of modern times will be determined by the infinitely varied influences on the decisions of hundreds of thousands of Chinese individuals and families.

Success in Hong Kong would change the map of political possibility in Taiwan. The Chinese Communist Party and the Kuomintang have lived with stalemate across the Straits for four decades. They can probably live with current ambiguities for a considerable while to come.

But rapidly rising incomes and democratization in Taiwan and the sudden intensification of personal and economic contacts with the mainland will introduce their own eddies and cross-currents across the Straits. The ambiguities will require closer management. And for as long as stalemate persists, there is some risk that sentiment for independence will lurch out of control. This is a point at which the government in Beijing might feel constrained to enter directly into the management of political life in Taiwan, whatever the cost.

I think that this is understood by leaders on both sides of the Straits, who might therefore calculate advantage in some nominal form of reunification that allowed life to proceed securely, separately and largely unchanged. The mainland has offered greater powers to a Taiwan

regional government than to Hong Kong, most importantly the power to maintain its own defence forces. With separate defence forces of considerable strength, Taiwan would be in a position to defend its separate system, while Hong Kong ultimately must rely on Beijing's word and will.

A Taiwan loosely integrated with a rapidly developing China would have profound influence on the pattern of social and economic change in China, and this would amount to a different kind of guarantee.

But most important of all will be all those decisions by Chinese in Hong Kong – the jury that is out on the case of 'One country, two systems'.

